such as the assessment of costs and expenses and the effect of efforts to stay proceedings in the state courts, will arise.

WHEREFORE, your Petitioner respectfully requests that a writ of certiorari should be granted as prayed.

Dated: April 28, 1942.

MANUFACTURERS TRUST COMPANY,
Petitioner,

By

CHARLES E. HUGHES, JR.,
DAVID BARNETT,
CURTISS ELY FRANK,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

References to the opinions of the court below and the grounds of jurisdiction, as well as a statement of the case and specifications of error to be urged, are contained in the petition and will not here be repeated.

FIRST: Under the law of New York, the claims here asserted for alleged breach of trust belong only to individual holders who held their bonds at the time such breaches of trust occurred. The Circuit Court of Appeals should have followed the state law and dismissed the objections of the trustees of the debtor, the new corporation and the advisory group, and of bondholders purporting to act for all other bondholders.

The Circuit Court of Appeals recognized that, since the question of the ownership of the claims depended upon the

effect of the assignment of the bonds, the New York decisions are authoritative (R. 520). In addition, the indenture was executed by a New York Debtor in New York and required that the trustee be a New York trust company or a national bank authorized to execute trusts in New York (R. 63, 67). Moreover, the application of the statute of limitations, which is governed by New York law, depends upon the nature and ownership of the claims.

We submit therefore that, whether or not New York law must be followed under the doctrine of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64 (see *D'Oench Duhme & Co. Inc.* v. *Federal Deposit Insurance Corp.,* No. 206 October Term 1941, decided March 2, 1942, 86 L. Ed. 642), the court below was correct in holding that New York law governs the rights of the bondholders under this indenture and the question whether an assignment of a bond vests in the assignee the cause of action based on alleged misconduct of the trustee occurring prior to the assignment. See *Thompson* v. *Magnolia Co.,* 309 U. S. 478, 484; *In Re Prudence Co.,* 82 F. (2d) 755, 757 (C. C. A. 2); *In Re 671 Prospect Avenue Holding Corporation,* 105 F. (2d) 960 (C. C. A. 2). If, however, there is any question about this, an additional reason is presented for the granting of certiorari here to determine finally the question whether the federal court should follow the state law on questions of this sort attempted to be litigated in bankruptcy proceedings.

We submit that the court below was clearly wrong in holding that the allowance of the objections filed by the Trustees of the Debtor, the New Corporation, the Advisory Group and bondholders purporting to act on behalf of bondholders who acquired their bonds after the alleged misconduct of the trustee occurred, was consistent with the decisions of the New York state courts.

There were in New York, prior to the depression and the bank holiday of 1933, two large companies and several smaller companies, in addition to the Prudence companies, engaged in the business of selling securities evidencing interests in guaranteed mortgages. *Seventy-fourth Annual Report of the Superintendent of Insurance of the State of*

New York, for the year ended December 31, 1932 to the Legislature (Legislative Document [1933] No. 35); Annual Report of the Superintendent of Banks of the State of New York for the year ending December 31, 1932, to the Governor and to the Legislature (Legislative Document [1933] No. 26). As shown by the New York cases about to be cited, one of these large companies, the New York Title & Mortgage Company, sold mortgage certificates guaranteed by it and issued by it against pools of bonds and mortgages deposited under depositary agreements with a predecessor of The Manhattan Company. The other large company, Title Guarantee and Trust Company, sold certificates guaranteed by its affiliate, Bond and Mortgage Guarantee Company, and issued for the most part against single bonds and mortgages held by Title Guarantee and Trust Company as depositary and agent under an arrangement set forth in the certificates. Both the New York Title & Mortgage Company and Bond and Mortgage Guarantee Company were taken over for rehabilitation and liquidation by the New York Insurance Department and, as a result, the litigation involving certificates guaranteed by them has been chiefly determined in the state courts. *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420, cert. den. 293 U. S. 619; *Tolfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702, cert. den. 293 U. S. 619; *Depen* v. *Lawyers' Title & Guaranty Company*, 72 F. (2d) 705, cert. den. 293 U. S. 619. It was only because the Debtor here, Prudence-Bonds Corporation, obligor on the bonds, was not a banking or insurance corporation but a business corporation, properly subject to reorganization under Section 77B, that litigation involving the Prudence bonds has happened to be in the federal courts.

In the litigation affecting New York Title & Mortgage Company and Title Guarantee and Trust Company certificates, the New York courts have consistently held, exactly opposite from the holding of the Circuit Court of Appeals in this case, that claims by certificate holders against the depositary or agent for permitting improper withdrawals, releases or substitutions of collateral were not class claims but were individual claims owned by the certificate holders

who held their certificates at the time of the alleged misconduct.

In the first of these cases to reach the Court of Appeals, *Mittlemann* v. *President, etc., of Manhattan Co.*, 248 App. Div. 79 (1st Dept.), aff'd 272 N. Y. 632, trustees appointed under the Schackno Act (L. 1933, c. 745, as amended) in the reorganization of Series Q, New York Title & Mortgage Company alleged that the depositary of the bonds and mortgages securing the certificates of that series breached the deposit agreement in various ways; among others, by accepting mortgages accompanied by no appraisal and no sworn certificate of appraisal, by accepting mortgages which were not valid first liens, by releasing from the deposit good bonds and mortgages and accepting in substitution therefor inferior bonds and mortgages, many of which were apparently not accompanied by appraisals or sworn appraisals (Record on Appeal, pp. 115-116, 118-119, 215, 219-220).

Briefs, several hundred pages in length, were submitted by eminent counsel, including counsel for many Schackno trustees as *amici curiae*. Plaintiffs contended that the reorganization plan promulgated under the Schackno Act and the court order approving the plan, both of which provided that "all of the title, rights, interests and powers of the [certificate] holders * * * in and to the property which now constitutes* *or rightfully should constitute the security* against which such * * * certificates have been issued, including * * * the rights of the holders * * * to enforce the liabilities * * * of the New York Title & Mortgage Company *and any other persons, firms or corporations,* shall immediately be transferred to and vest in the Trustees and their successors" (Record on Appeal, pp. 140, 124), conferred upon the Schackno trustees the power to bring suit on behalf of all certificate holders for such breach of trust. The reorganization declaration of trust provided that the Schackno trustees were vested with the right to enforce "any and all rights and claims which the Certificate-holders * * * *as a class* may

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*All italics in quotations in this brief are supplied unless otherwise noted.

have * * * against any * * * corporation" (Record on Appeal, p. 163).

The Appellate Division, reversing Special Term, and granting a motion to dismiss the complaint, said (248 App. Div. p. 81):

> "The Schackno Act was never intended to result in granting to Schackno trustees the right to bring causes of action asserting the alleged tort claims of the individual certificate holders based on the claimed violation at various times of duties allegedly owed to each of them individually under the contract of the mortgage company and the depositary.
>
> "The causes of action sued on are not causes of action which the series Q certificate holders have 'as a class'. They are individual claims or choses in action."

The Court of Appeals unanimously affirmed without opinion (272 N. Y. 632).

Thereafter, a similar suit was brought by the trustees of Series C-2 of New York Title & Mortgage Company for misconduct of substantially the same sort alleged in the *Mittlemann* case (*Weil* v. *President, etc., of Manhattan Co.*, 275 N. Y. 238). The Court of Appeals was urged to re-examine its decision in the *Mittlemann* case (275 N. Y., p. 242) and granted permission to appeal from the unanimous affirmance by the Appellate Division of the judgment of the Special Term dismissing the complaint. Plaintiffs stressed that there were 25,000 certificate holders in the various issues of the company who, it was argued, would not be adequately protected unless class suits by the Schackno trustees were held to lie (Plaintiffs' main brief, p. 16). The Court of Appeals, reaffirming its holding in the *Mittlemann* case, said (pp. 242-243):

> "The causes of action alleged in the complaint are not of that nature [*i.e.* not held by the certificate holders 'as a class'] *because the interest of each certificate holder depends upon the time and circumstances under which he became a certificate holder.* Some have no possible cause of action and some of the causes of

> action alleged *vested in previous certificate holders who have transferred their certificates.* The rights of those who may have causes of action vary."

The rule that causes of action such as that involved in the instant case are limited to holders who owned their bonds or certificates at the time of the alleged breaches of fiduciary duty is even more strikingly evidenced by the litigation against the Title Guarantee and Trust Company.

Hendry v. *Title Guarantee & Trust Co.*, 255 App. Div. 497 (1st Dept.) was not a suit by Schackno trustees but was an action for an accounting by holders of certificates suing for themselves and for others similarly situated. The Trust Company, which held legal title to the underlying mortgage as agent and depositary had improperly released a condemnation award to the property owner, thus reducing the security without the knowledge of the certificate holders. The Special Term had held (165 Misc. 349) that the defendant was liable to all of the plaintiffs. Three of the plaintiffs, however, had acquired their certificates after the defendant's improper release of the security, two of them by purchase from the defendant, and the third by inheritance from her sister. The Appellate Division held that these three plaintiffs were not entitled to share in the recovery, saying (255 App. Div. p. 500):

> "When Buse and Germond purchased their certificates they acquired only a participation in the mortgage as it existed at that time. The plaintiff MacLean acquired by inheritance only the certificate, not her sister's then existing cause of action for the depreciation in value resulting from the act of the defendant in releasing the security. The cause of action for that breach of trust did not pass from hand to hand with the certificate. (Compare *Weil* v. *President and Directors of Manhattan Co.*, 275 N. Y. 238). We think the rule applied in *Hanna* v. *Florence Iron Co.*, (222 N. Y. 290), and in *Schaffer* v. *Vandewater & Co. Ltd.* (160 App. Div. 803), that the assignment of a contract does not include a right of action for a previous breach, is also applicable here."

In *Horwitz* v. *Title Guarantee and Trust Company*, 259 App. Div. 815 (1st Dept.) the court unanimously affirmed without opinion an order of the Special Term dismissing a complaint of a Schackno trustee which, as appears from the record on appeal, sought recovery for breaches of duty in failing to collect installments of mortgage principal. As appears from the briefs in that case the plaintiff attempted to distinguish the *Mittlemann* and *Weil* cases on the ground that the action was one for maladministration of the mortgage *res. Matter of Mortgage Commission (Lido Club Hotel)* 261 App. Div. 840 (2nd Dept.) affirmed without opinion instructions to Schackno trustees to refrain from prosecuting an action against Title Guarantee and Trust Company predicated, as appears from the record on appeal, upon similar alleged breaches of trust.

The Circuit Court of Appeals' treatment of the above New York decisions, and of others which Petitioner cited below, is, we submit, wholly unsatisfactory. It consists of an attempt to dispose of each case on different factual distinctions and ignoring the total impact of the evidence of the New York law which is inherent in the line of cases as a whole.

Thus the Court below (125 F. (2) 652) said of the *Mittlemann* and *Weil* cases, *supra*, that all that the court actually held was "that the plaintiffs who were 'Schackno trustees' did not succeed to the rights of the bondholders against the defendants". But, as we have shown above, the chief reason on which the New York Court of Appeals held that claims based upon the same kinds of wrong as are involved here did not pass to the Schackno trustees was that they were not held by the certificate holders "as a class" but were individual causes of action the validity of which depended upon the time and circumstances under which the claimants respectively became certificate holders. Moreover, the New York decisions involving New York Title & Mortgage Company certificates were not confined to those in which the plaintiffs were Schackno trustees. In *Hetner* v. *President and Directors of The Manhattan Company*, 251 App. Div. 718 (1st Dept.), the Appellate Division held, as appears in the Record on Appeal, that an action brought by certificate holders

"suing individually and on behalf of all others similarly situated" against the depositary was improperly brought as a class action under Section 195 of the New York Civil Practice Act, but permitted an amendment of the complaint to allow plaintiffs to plead individual causes of action which could be joined under Section 209 of the New York Civil Practice Act. And in *Frank* v. *President & Directors of Manhattan Co.*, 168 Misc. 741 (Spec. T., N. Y. County) where certificate holders endeavored to bring a representative action against the depositary, the court, in dismissing the complaint, said (p. 742):

> "The alleged wrongs might affect the several certificate holders in different degrees, *depending upon whether they were holders at the time one or more of the wrongs were committed.*"

Furthermore, the *Hendry* case, *supra,* was not brought by Schackno trustees but by certificate holders. There the Special Term had held with respect to the three plaintiffs who had acquired their certificates after the alleged wrongs (165 Misc. p. 354):

> "With the acquisition of the certificates by these three plaintiffs went all the rights and privileges and obligations inherent in and which attached to the certificates. I hold that these three plaintiffs are entitled to share in the recovery. (*Pollitz* v. *Gould,* 202 N. Y. 11.)

This was the holding which, as above shown, the Appellate Division unanimously reversed.

The court below then goes on to its second ground of distinction (125 F. (2) 652) which was that "the defendant, which was merely a custodian of the documents, was not like a trustee". This distinction the Court urged not only with respect to the *Mittlemann* and *Weil* cases and other cases involving New York Title & Mortgage Company certificates but to the *Hendry* case involving Title Guarantee and Trust Company certificates.

Whether or not this attempted distinction has any legal validity* it had no part in the *ratio decidendi* of the cases

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*It is submitted that there is no valid distinction between the legal relationships involved in the New York Title & Mortgage Company, the Title Guarantee and Trust Company and the Prudence-Bonds instruments, respectively. The depositary agreement of the New York Title & Mortgage Company provided in detail that that company was under positive duty to deposit with the Manhattan Company mortgages accompanied by sworn appraisals of adequate value and the right of withdrawal and substitution was dependent upon such appraisals. The Manhattan Company was a party to that agreement and the certificates authenticated by it incorporated the terms of the agreement. The certificates issued by the Title Guarantee and Trust Company and signed by it placed positive duties upon and powers in it providing in part that: "The Company * * * shall continue to hold said bond and mortgage * * * for the benefit of the purchaser and any other persons interested therein. * * * The Company shall have full power to take any action it may deem necessary or desirable in order to enforce any of the provisions of the said bond and mortgage and to protect the mortgage security". *Title Guarantee & Trust Company* v. *Mortgage Commission*, 273 N. Y. 415, 419. These duties of the so-called "depositary" and "agent" were at least as strong as those of Petitioner here with respect to the Prudence Bonds. In the case of the Prudence Bonds, Petitioner as trustee apparently had no positive contractual powers or duties with respect to the underlying collateral before default (See *Rhinelander* v. *Farmers' Loan & Trust Co.*, 172 N. Y. 519, 536) whereas the Title Guarantee and Trust Company had at all times full control over the underlying bond and mortgage. The mere appellation of "trustee" is without legal significance. In *Hazzard* v. *Chase National Bank of New York*, 159 Misc. 57, aff'd without opinion in 257 App. Div. 950, and 282 N. Y. 652, cert. den. 311 U. S. 708, Justice Rosenman said: "In such [corporate trust] indentures the use of the word 'trustee' is clearly a misnomer. The corporate trustee has very little in common with the ordinary trustee, as we generally understand the fiduciary relationship. * * * His status is more that of a stakeholder than one of a trustee" (159 Misc. 83-84). (See also *Meisel* v. *Central Trust Co.*, 179 App. Div. 795, aff'd 223 N. Y. 589; *Matter of Accounting of Neilley*, 95 N. Y. 382; *Matter of Ihmsen*, 253 App. Div. 472.) The fact that the Petitioner may hold legal title is immaterial. The Title Guarantee and Trust Company specifically held legal title to the mortgages there involved. *E. T. C. Corp.* v. *Title Guarantee & Trust Co.*, 271 N. Y. 124, 130. In the case of Prudence Bonds there was a pledge by the Debtor, and normally legal title remains in the pledgor. There was at least sufficient legal title in the Debtor to permit its reorganization under Section 77B and whatever title the Petitioner held as trustee was merely a security title. (*In re Prudence-Bonds Corporation*, 77 F. (2d) 328, 330; cert. den. 296 U. S. 584; *In re Prudence Bonds Corporation* v. *Chemical Bank & Trust Co.*, 79 F. (2d) 205 (C. C. A. 2); *In re Prudence Bonds Corporation*, 79 F. (2d) 212, 217.)

sought to be thus distinguished. Not only was there no discussion of any question whether the defendant was a trustee, or only a depositary or agent, but the opinions contained affirmative evidence that any such question was regarded as without significance. In the *Hendry* case the Special Term said (165 Misc. p. 352):

> "The certificate holders should have been apprised of the situation. In effect, it makes no difference whether the defendant was a trustee in a technical sense or a mere agent. It was a fiduciary, with all that the office imposes and implies. (*Marvin* v. *Brooks*, 94 N. Y. 71, 78.) It owed a duty to the certificate holders, and that duty was not casual or perfunctory."

and the Appellate Division opinion said (255 App. Div. 499):

> "We agree with the Special Term that a *trustee or* agent has no power ordinarily to release any part of the security in his possession no matter how adequate the security remaining may appear."

In *Rabinowitz* v. *President and Directors of The Manhattan Company*, 275 N. Y. 453, a companion case to the *Mittlemann* and *Weil* cases, in which the Court of Appeals affirmed without opinion a judgment dismissing the complaint of Schackno trustees, the statement of the case by the court reporter contains the following sentence:

> "The defendant, at the time this action was commenced, was the trustee and depositary of collateral security for such certificates."

This was of course not a statement by the court but it tends to confirm the indication from the other cases that any such distinction as that suggested by the Circuit Court of Appeals below was not regarded as of any significance.

Conclusive refutation of any supposition that the New York law on this subject makes any distinction between a corporate trusteeship and a depositary or agency relation appears in the case of *Elkind* v. *Chase National Bank*, 259 App. Div. 661, aff'd without opinion 284 N. Y. 726. In that case the defendant was unquestionably a trustee. A bond-

holders' representative action was based on a charge that it, while trustee of the bond issue, obtained payment to itself of certain bank loans through a subsidiary of the obligor on the bonds, which was used to siphon off the profits and good will of the obligor which otherwise would have remained as additional security for the bonds. The Appellate Division held that the good will had not been pledged as part of the mortgage, that the action was simply for breach of trust, and that therefore a bondholders' representative action would not lie. The court stated that only individual bondholders who held their bonds at the time of the alleged breaches of trust could bring suit.

The ground upon which the Circuit Court of Appeals (125 F. (2) 653) below attempted to distinguish this case (the ground that the defendant was not a trustee being plainly unavailable) was that the action was not, as it construed the instant case to be, one to recover a part of the mortgage *res*. The attempted distinction overlooks the fact that other New York cases in the line on which we rely were as much of that character as the case at bar. The court in the *Elkind* case relied strongly (259 App. Div. p. 666) on the *Hendry* case, which, as above pointed out, was an action to recover the amount of a condemnation award wrongfully released by the fiduciary. The Special Term in that case (165 Misc. p. 353) said: "If, as we see, the award supersedes the land, the certificate holders automatically become partners in the award." In most of the cases involving certificates of the New York Title & Mortgage Company, above cited, the alleged breaches of trust included the release of mortgages without adequate substitutions. It is perfectly plain from the opinion in the *Elkind* case that what the court meant by a suit to "recover" the *res* was limited to cases where the corporate trustee had received for its own benefit a part of the property covered by the mortgage. This is plain enough from the language of the court at page 664 of the opinion which the Circuit Court of Appeals below (125 F. (2) 653) itself quotes. But it appears unmistakably from the following extract from the Appellate Division's opinion at page 665:

> "If defendant wrongfully took such money proceeds *for itself,* its breach, if any, was of a fiduciary duty for which it may be held to account in a proper action instituted on behalf of aggrieved individual bondholders, but a bondholders' representative action for an accounting for *damages for breach of trust,* as distinguished from a suit to recover property that was subject to the lien of the mortgage, cannot be maintained by these plaintiffs."

The court cited and relied on the *Hendry, Mittlemann* and *Weil* cases as representing the governing rule. The distinction which the Appellate Division made was manifestly between recovering from the trustee the trust property itself or its misappropriated proceeds, on a theory of constructive trust or otherwise, and a suit for damages to be payable out of the general assets of the defendant.

The combined effect of the *Elkind* case, and the *Hendry, Mittlemann* and *Weil* cases on which it relies, clearly indicate that the law of New York is that such claims belong only to bondholders who held their bonds at the time of the alleged misconduct, whether the defendant be a trustee, or some other kind of fiduciary. The principle, in the language of the court in the *Elkind* case, is that "A trustee cannot, before the relationship is established, have violated a trust duty." (259 App. Div. 666.) See *Doyle* v. *Chatham & Phenix Nat. Bank,* 253 N. Y. 369.

The New York law was so interpreted in a very recent decision by the court of first instance in *Emmerich* v. *Central Hanover Bank & Trust Co.* (Special Term, New York Co., New York Law Journal, March 10, 1942, p. 1040). In that case the defendant was unquestionably a trustee and the cause of action was based upon allegations, among others, that it had improperly permitted a valuable lease and agreement, which was part of the mortgage security, to be cancelled and abrogated. The complaint did not allege that the plaintiff bondholder was such at the time the alleged breaches of trust were committed. The court, relying principally upon the *Elkind* case and the *Hendry* case, dismissed the complaint. We attach a copy of the opinion as an appendix to this brief.

Where state law is to be applied in the federal courts, a decision of a court of first instance may be as persuasive evidence of the state law as that of the highest court, where there is no authority in the appellate courts to the contrary (*Fidelity Trust Co.* v. *Field,* 311 U. S. 169). The *Emmerich* case, above referred to, cannot be distinguished upon any of the grounds suggested by the Circuit Court of Appeals below, and the Circuit Court of Appeals' opinion cites no New York case which is contrary to that decision. In fact it cites no New York decision which has any tendency to support the conclusion which it reached. The best that it could do with the New York authorities was to attempt to pick them off one by one with various differing, and often tenuous factual distinctions. This is not the spirit in which the decisions of this Court require the federal courts to approach the interpretation of the law of the State. In *West* v. *A. T. & T.,* 311 U. S. 223, 237, this Court said:

> "State law is to be applied in the federal as well as the state courts and it is the duty of the former in every case to ascertain *from all the available data* what the state law is and apply it rather than to prescribe a different rule, *however superior it may appear from the viewpoint of 'general law'* and however much the state rule may have departed from prior decisions of the federal courts. See *Erie Railroad Co.* v. *Tompkins, supra,* 78; *Russell* v. *Todd, supra,* 203."

We submit that here the court below did not follow that admonition, and that it is impossible to read the line of New York cases which we have above cited without reaching the conclusion that the New York courts would decide the controversy here involved contrary to the decision below. The court below followed its attempted distinction of the *Elkind* case with an argument on principle, supported only by citations from other jurisdictions and a text-book, designed to indicate that the rule which it announced was "superior" to that which would result from the rule which we submit is established by the New York cases. But all of the alleged

injustices* which the court said would follow from confining a cause of action for surrender of the security to bondholders who were such at the time of the misconduct would apply equally whether the defendant fiduciary were a strict trustee or a "depositary" or "agent".

It is general New York law applying even to accountings by estate and other fiduciaries, that no beneficiary may object to such fiduciary's account except in respect of wrongs which he himself has sustained, and he may seek redress for himself only. *Matter of Garvin,* 256 N. Y. 518, 521; *Matter of Ellensohn,* 258 App. Div. 891 (2nd Dep't); *Matter of Hurewitz,* 174 Misc. 182; *Matter of Stumpp,* 153 Misc. 92; *Matter of Dempsey,* 259 App. Div. 1083 (2nd Dep't); *Matter of Sul-*

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*We submit that at least equal injustice would be attendant upon the rule announced by the Circuit Court of Appeals below. Many of the bondholders who would be permitted to recover under the decision below bought their bonds at low prices during the depression long after the breaches of trust occurred, and allowance of their claims would be at the expense of bondholders who disposed of their bonds at low prices and who under New York law rightfully own the claims (See R. 460; Findings 36, 37). Many of the bonds were not even authenticated until after the alleged breaches of trust occurred (R. 100-102) and so are not entitled to recover (*Doyle* v. *Chatham & Phenix Nat. Bank,* 253 N. Y. 369, *supra*). If the judgment of the Circuit Court of Appeals below stands in favor of all present bondholders, it will be no protection to the petitioner against claims which may be made by those who held the bonds at the time of the alleged breaches of trust, who are not before this court and who will not be bound by the judgment. If the claims are class claims belonging to all present bondholders, the Guarantor which owned $390,500 of Twelfth Series bonds (R. 340) and stockholders, officers and directors of the Guarantor and Debtor who owned many of the bonds (R. 256) will apparently share in any recovery despite the fact that they caused and obtained the benefit of the withdrawals which are the subject of complaint, contrary to New York state law as established in *Butterfield* v. *Cowing,* 112 N. Y. 486. (See also *Matter of Garvin,* 256 N. Y. 518.) Finally, the Prudence plans contemplate that any excess in any particular series, after the complete retirement of the bonds in that series, will become proportionately available to the collateral of all other series (R. 219-220). Therefore, if these claims are considered class claims, bondholders of entirely different series may conceivably obtain the ultimate benefit of any recovery rather than those who, because they held their bonds at the time of the alleged breaches of trust, have suffered any actual damage that may have occurred.

livan, 177 Misc. 570; *Giles Dyeing Machine Co.* v. *Klauder-Weldon D. M. Co.,* 233 N. Y. 470; *Matter of Wechsler,* 173 Misc. 802.

It is unnecessary to consider separately the right of the trustees of the Debtor, the New Corporation and the Advisory Group to file objections to Petitioner's account. Their right to file objections is necessarily derived from the bondholders they purport to represent, and if the claims asserted are individual claims belonging only to those who held bonds at the time of the respective alleged breaches of trust they are not and have not been vested in these three representatives or any of them (R. 341-342, 415-416). *Barnes* v. *Hirsch,* 215 App. Div. 10, aff'd 242 N. Y. 555, cert. den. 273 U. S. 709; *Tannenbaum* v. *Seacoast Trust Co. of Asbury Park, et al.,* 16 N. J. Misc. 234, 198 Atl. 855, 872, aff'd 125 N. J. Eq. 360, 5 A. (2d) 778; *Seeymiller* v. *Day,* 249 Fed. 177 (C. C. A. 7); *Meyer* v. *Lowry & Co., Inc.,* 257 App. Div. 81.

SECOND: Under the law of New York, which the Circuit Court of Appeals should have followed, the six-year statute of limitations is applicable and bars the claims covered by the objections here in question.

It seems to be undisputed that the law of New York should be followed by the federal courts in determining whether or not these objections are barred by the statute of limitations. *Miles* v. *Vivian,* 79 Fed. 848 (C. C. A. 2); *Frismuth* v. *Farmers' Loan & Trust Co.,* 107 Fed. 169, 173 (C. C. A. 2); *Guaranty Trust Co.* v. *U. S.,* 304 U. S. 126, 136-137; *West* v. *A. T. & Co.,* 311 U. S. 223. See *City Company of New York, Inc.* v. *Stern* and *Chase Securities Corp.* v. *Vogel,* 312 U. S. 666.

The Circuit Court of Appeals utterly ignored the decisions of the New York courts relating to the statute of limitations governing claims against corporate trustees predicated upon alleged breaches of fiduciary duties under collateral trust indentures.

The Circuit Court of Appeals held summarily (125 F. (2) 654) that, since the claims here involved were for restitution of the *res* under an express trust, no statute of limitations begins to run "until the trustee has repudiated the trust to the beneficiary's knowledge, or himself invokes the aid of the court to pass his accounts".

For this proposition the court cites a single New York case, *Ludington* v. *Thompson*, 153 N. Y. 499, which is inapposite on its facts. The general rule relating to express trusts to which the New York Court of Appeals adverted by way of *dictum* (153 N. Y., p. 505) is by no means uniform, as the Court itself recognized (153 N. Y., p. 506), and with respect to actions against corporate trustees of collateral trust indentures, the New York law is, we submit, clear that ordinary statutes of limitations are applicable to actions for breach of their fiduciary duties. *Rhinelander* v. *Farmers Loan & Trust Co.*, 172 N. Y. 519; *Frismuth* v. *Farmers Loan & Trust Co.*, 95 Fed. 5, aff'd 107 Fed. 169 (C. C. A. 2).

In those cases bondholders sued the trustee of the same railroad mortgage, alleging that the trustee certified and issued bonds with knowledge that the obligor had not fulfilled the requirements of the indenture as to the purposes for which the proceeds were to be applied and without requiring proper written orders from it. Under the indenture the trustee was to certify and issue bonds only upon orders of the obligor which were to include statements declaring the purpose for which the proceeds of the bonds so ordered were to be appropriated. Neither court entertained any idea that no statute of limitations began to run until repudiation by the trustee. The sole question was what period of limitation, after the accrual of the cause of action, governed. The plaintiffs contended that the trustee had been guilty of breach of an implied covenant in the indenture and hence the twenty-year statute (now Civil Practice Act, Sec. 47) applying to "an action upon a sealed instrument" governed. The Court held, however, that the obligation breached by the trustee was not an implied covenant in the mortgage but "an implied legal duty or obligation springing from the rela-

tion of trustee and *cestui que trust*" (172 N. Y., p. 531). The trustee had signed the instrument (as did the Petitioner in this case) only to accept the trust. Accordingly the twenty-year statute did not apply, and the question whether the applicable period was six years (present Civil Practice Act, Sec. 48) or ten years for "an action, the limitation of which is not specifically prescribed in this article" (present Civil Practice Act, Sec. 53) was not involved since the breaches of trust occurred more than ten years before action was brought. Both those actions were begun in 1899 (172 N. Y., p. 536; 95 Fed. p. 5), and the last breach of trust occurred in 1885 (*id.*, p. 529). The Court's indication in the *Rhinelander* case that the ten-year statute was the applicable one accordingly was *dictum*. In the *Frismuth* case the indications from the Court's statement that the defendant's conduct "may be regarded as a breach of a *quasi* contract or a contract implied in law" (107 Fed., p. 174) and from the attempt to amend the complaint in the companion *Antelo* case (107 Fed., p. 174) are that the Court regarded the six-year statute as applicable. Both cases are square authority against the theory of the Circuit Court of Appeals herein. The bonds secured by the indenture were not due until October 1, 1900 (172 N. Y., p. 523); the trust could therefore on no theory have terminated when the actions were commenced, and it had not been repudiated.

The question as between the six and ten-year statutes was definitely decided in the recent case of *Savings Bank of New London* v. *New York Trust Co.*, 27 N. Y. S. (2d) 963 (Supreme Court, N. Y. County, May 9, 1941), which was also an action by bondholders against the trustee of a railroad mortgage for misconduct. In 1929, the defendant trust company, at the request of the railroad obligor, released from the lien of the mortgage certain stock, bonds, leases and other property, and in 1930 and 1931 certain physical properties which were then sold. The trustee, instead of requiring the proceeds of the sale to be turned over to it, accepted certain bonds covered by the same mortgage, which were held to have been discharged when acquired by the railroad and were

therefore nullities when received by the trustee. The court held that there had not been a violation of any express covenant but rather a breach of an implied duty, and, since an action at law would lie, the six-year statute of limitations was applicable. This case is also authority against the theory of the Circuit Court of Appeals herein because there had apparently been no repudiation of the trust by the trustee.

The decision that the six-year, rather than the ten-year, statute is the one applicable is in accordance with a line of New York cases about to be cited, brought by certificate holders against the Title Guarantee and Trust Company for analogous breaches of fiduciary obligations. These cases are as clearly in point on that question as are cases involving mortgage trustees because, obviously, the question whether the fiduciary is the usual corporate trustee or an agent, depositary or other sort of fiduciary has nothing to do with whether the ten-year or the six-year statute governs. That distinction could be material only on the theory advanced by the Circuit Court of Appeals that the statute does not begin to run against a trustee until repudiation of the trust, which theory, as we have above pointed out, is disposed of by the *Rhinelander* case, *supra*. It is only where a defendant fiduciary is obliged to account for property taken by itself that the ten-year statute may apply. See *Potter* v. *Walker*, 276 N. Y. 15. Actions for breaches of fiduciary duties wholly analogous to those involved in the present case have uniformly been held to be barred by the six-year statute of limitations on the ground that for them actions at law would lie. *Kesner* v. *Title Guarantee & Trust Co.*, 259 App. Div. 597 (1st Dept.) aff'd 284 N. Y. 622 (action based on defendant having extended the underlying mortgage without disclosing to plaintiff that certain portions of the mortgaged premises had been previously released by defendant); *Clark* v. *Title Guarantee & Trust Co.*, 259 App. Div. 136 (1st Dept.), aff'd 284 N. Y. 619 (based on defendant having extended the mortgage without the knowledge or consent of the plaintiff and having improperly failed to collect principal and interest on the bond

and mortgage); **Follender* v. *Title Guarantee and Trust Company,* 258 App. Div. 724 (1st Dept.) (based on defendant having released to the mortgagor a condemnation award, which was part of the mortgage security, without the knowledge or consent of the certificate holders (Record on Appeal, pp. 2-3, 20, 23); **Fichter* v. *Title Guar. & Trust Co.,* New York Law Journal, August 9, 1939, p. 327).

In *Kesner* v. *Title Guarantee and Trust Company, supra,* the Appellate Division, which the Court of Appeals affirmed without opinion, said (259 App. Div. p. 598):

> "Plaintiffs have a complete remedy at law to recover the money damages sought in the complaint. (*Strebler* v. *Title Guarantee & Trust Co.,* 250 App. Div. 846; modfd. in other respects, 277 N. Y. 730). In similar actions for breach by defendant of the duty which it owes as agent to a certificate holder, it has been held that an adequate remedy at law exists to which the six-year Statute of Limitations must be applied. (*Follender* v. *Title Guarantee & Trust Co.,* 258 App. Div. 724; *Clark* v. *Title Guarantee & Trust Co.,* 259 *id.* 136).
>
> Though plaintiffs might maintain an action in equity to recover for constructive fraud, there is, nevertheless, a concurrent adequate remedy at law for damages. The rule is settled that when a legal and an equitable remedy exist as to the same subject-matter,

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*The *Follender* and *Fichter* cases, *supra,* are also direct authority against the applicability of the 20-year statute. In both those cases the plaintiff argued that the suits were upon sealed instruments, namely the certificates, but the courts, specifically citing the *Rhinelander* case, sustained motions to dismiss on the ground that the six-year statute applied. New York Law Journal, October 6, 1938, page 999 and August 9, 1939, page 327. In the former case the opinion of the Special Term, which the Appellate Division affirmed, said:

> "I am unable to perceive that this action is upon a sealed instrument. It stems from the relationship of the parties; it does not rest upon any breach of a covenant. Nor is it a suit upon the certificate (*Rhinelander* v. *Farmers Loan & Trust Co.,* 172 N. Y., 519)."

See also *Trustees of Mission Church* v. *Ridley,* 167 App. Div. 392 (1st Dept.); *Syracuse Savings Bank* v. *Onondaga Silk Co.,* 175 Misc. 811 (Supreme Court, Onondaga County).

the latter is under the control of the same statutory bar as the former. (*Keys* v. *Leopold*, 241 N. Y. 189; *Hanover Fire Ins. Co.* v. *Morse D. D. & R. Co.*, 270 *id.* 86)."

Other cases holding that an action at law lies against a corporate trustee for breach of trust are: *Hunsberger* v. *Guaranty Trust Company*, 164 App. Div. 740 (1st Dept.); *Margulies* v. *Manufacturers Trust Co.*, 148 Misc. 564 (App. Term, 1st Dept.); *Bank of New York* v. *N. J. Title Guar. & Trust Co.*, 256 App. Div. 609 (1st Dept.); *Cf. Kane* v. *Bloodgood*, 7 John Ch. 90, aff'd 8 Cowen 360; *James* v. *Cowing*, 82 N. Y. 449. Even if there is also an equitable remedy, that remedy is governed by the legal statute of limitations. *Kesner* v. *Title Guarantee and Trust Co., supra; Keys* v. *Leopold*, 241 N. Y. 189. And where the six-year statute is applicable, the plaintiff's ignorance of the facts is immaterial. *Scott on Trusts*, Section 219; *Keys* v. *Leopold*, 241 N. Y. 189; *Chance* v. *Guaranty Trust Co. of New York*, 173 Misc. 754, 762, aff'd 257 App. Div. 1006, aff'd 282 N. Y. 656; *Libby* v. *Van Derzee*, 80 App. Div. 494, aff'd 176 N. Y. 591, reargument denied 177 N. Y. 567; *Wechsler* v. *Bowman*, 285 N. Y. 284, 293; *Schmidt* v. *Merchants Despatch Trans. Co.*, 270 N. Y. 287, 300.

THIRD: The bankruptcy court has no jurisdiction over the subject matter of the objections in question.

The Circuit Court of Appeals entertained jurisdiction over the objections here in controversy, following in that connection its decision in *Central Hanover Bank & Trust Company* v. *President and Directors of Manhattan Company*, 105 F. (2d) 130. No application for certiorari was made to review that decision at the time. However, the question of the jurisdiction of the Court over the subject matter of the controversy is open at all times, regardless of the previous attitude of any party thereto, and is one which may be raised by the Court *sua sponte*. *M. C. & L. M. Railway Co.* v. *Swan*,

111 U. S. 379; *Minnesota* v. *Northern Securities Co.*, 194 U. S. 48; *Treinies* v. *Sunshine Min. Co.*, 308 U. S. 66. It is therefore necessary to re-examine the basis of that decision at this time.

If we are right in our first contention that the claims here asserted by the objectors are not class claims, but belong only to those who held their bonds at the time that the alleged breaches of trust occurred, we submit that the absence of bankruptcy jurisdiction is plain. Such individual causes of action are not within even the most latitudinarian conception of the Debtor's property. Not only would any sums recovered from Petitioner not be of property in which the Debtor has or had any interest, but it is not property in which any class of the Debtor's creditors at the time the bankruptcy proceedings were instituted had any interest as such. They are simply causes of action which persons who were once creditors of the Debtor have against a party which has allegedly injured their particular property interests. One of the objectors' own proposed conclusions of law, No. 47, which was refused by the Special Master but ordered found by the District Court (R. 492, 502), stated (R. 325):

> "47. This Court, in these reorganization proceedings, does not have, and has not taken, jurisdiction over personal and individual claims or common law causes of action or choses in action of bondholders or others, for damages, against Manufacturers Trust Company, as Trustee of Prudence-Bonds, Twelfth Series."

But even if the claims were held to be class claims, in which all present bondholders had an equal and ratable interest, jurisdiction in the bankruptcy court would still, we submit, be lacking. They would not be claims that accrued to the Debtor at any time; nor would they be based on any injury done to the Debtor or to its property, or on any damage which it has at any time sustained. Any recovery on such claims would not be of property in which the Debtor has or at any time had any interest. Although the persons in whose favor the claims may have accrued are bondholders

of the Debtor and even assuming that for the purposes of such claims they may be held to constitute a "class"—nevertheless, they are not in respect of such claims creditors of the Debtor, but creditors of their indenture trustee in their own right.

The Circuit Court of Appeals seems to have supposed (105 F. (2d), p. 131) that, but for the fact that the Debtor was "a participant in" and "the instigator of" the alleged breaches of trust, jurisdiction would be clear. All of the examples cited by it for what it calls the "extended meaning of the debtor's property" (p. 132) were of property which should have been a part of the estate of the bankrupt at the time the bankruptcy proceeding was commenced, but which the bankrupt had permitted to go to others, *i.e.*, property which the bankrupt had fraudulently conveyed (Sec. 70(a)(4)), or which had been transferred preferentially (Sec. 60(b)), and property which might be reached by a judgment creditor (Sec. 70(c)). But the participation of the Debtor in the alleged wrong is not the only, or the chief, point of our contention. The point is that the property here in question was property to which, by the claimants' hypothesis, the Debtor was not entitled, but which the Trustees' alleged misconduct permitted to reach the Debtor. Petitioner's conduct which is complained of swelled, not depleted, the Debtor's estate before bankruptcy.

The Circuit Court of Appeals does not assert that trustees in reorganization under Article 10 have greater powers, in this respect at least, than ordinary bankruptcy trustees. It cites Sections 186 and 187 for the point that a reorganization trustee has "all the power of an ordinary trustee" or of a receiver in equity, and its citation of *McCandless* v. *Furlaud*, 296 U. S. 140, and *Pittsburg Carbon Co.* v. *McMillin*, 119 N. Y. 46, is for the point that an equity receiver may have a better standing than the debtor would have. That is but a part of the Court's attack upon the theory that the Debtor's participation in or instigation of the wrong is not a bar to the trustees, which, as we have pointed out, is not the point. Similarly, the Court's theory (p. 132) that the various groups of creditors "constitute a hierarchy of mutually inde-

pendent interests" is irrelevant. The authority of the Trustee to recover property for the benefit of any group in that hierarchy is, we submit, limited to property which was, or should have been, the Debtor's. *McCandless* v. *Furlaud, supra,* which was an extreme application of rules regarding a receiver's standing to sue, was still of the latter category.

We submit that the question thus presented should be determined by this Court. The Circuit Court of Appeals cites no authority for its conclusion which is even analogous on its facts. There is authority, which we submit is analogous, to the contrary, in a line of cases holding that statutory liabilities such as that imposed on directors for the corporation's debts when they have declared dividends while the corporation was insolvent, or in excess of its capital stock, and the statutory liability of stockholders, cannot be enforced by a trustee in bankruptcy, although recovery would have benefited creditors as a class, when under the law of the state they are personal to the creditors. *Seegmiller* v. *Day,* 249 Fed. 177 (C. C. A. 7); *In re Crystal Spring Bottling Co.,* 96 Fed. 945 (D. C., Vt.); *In re Jassoy Co.,* 178 Fed. 515 (C. C. A. 2); *Courtney* v. *Georger,* 228 Fed. 859 (C. C. A. 2), cert. den. 241 U. S. 660; *In re Beachy Co.,* 170 Fed. 825 (D. C., Wis.); *In re Huffman-Salvar Roofing Paint Co.,* 234 Fed. 798 (D. C., Ala.). See *Jacobson* v. *Allen,* 12 Fed. 454.

The present controversy properly belongs, we submit, in the State court having jurisdiction over the indenture trustee, to which such trustee is required to account and the law of which must in any event determine the result.

CONCLUSION

The petition for a writ of certiorari should be granted.

Dated: New York, April 28, 1942.

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